May 22, 1998

D.P.U./D.T.E. 97-94

Petition of New England Power Company, Massachusetts Electric Company, and Nantucket Electric Company, pursuant to General Laws Chapter 164, §§ 76 and 94, and 220 C.M.R. §§ 1.00 et seq., for review of its proposal to sell substantially all of New England Power Company's non-nuclear generating assets to USGen New England, Inc.

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I. INTRODUCTION

Pursuant to the terms of the restructuring settlement approved by the Department of Telecommunications and Energy ("Department" or "D.T.E.") in docket Massachusetts Electric Company, D.P.U. 96-25,[1] New England Power Company ("NEP" or "Company"), a wholly owned subsidiary of the New England Electric System ("NEES"), filed a petition for approval to sell substantially all of NEP's non-nuclear generating assets (the "divestiture transaction") to USGen New England, Inc. ("USGenNE").[2] As part of the divestiture transaction, NEES will contribute its stock in Narragansett Energy Resources Company ("NERC") to NEP,[3] and NEP

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1 On October 1, 1996, Massachusetts Electric Company ("MECo") submitted a settlement of electric industry restructuring issues ("Retail Settlement"), including a wholesale stipulation and agreement ("Wholesale Settlement") to the Department for review. The Retail Settlement was originally approved by the Department on February 26, 1997. On May 28, 1997, NEP submitted an amended Wholesale Settlement to the Federal Energy Regulatory Commission ("FERC") for review, and MECo filed an amended Retail Settlement, which included the amended Wholesale Settlement, with the Department for review. The Department approved the amended Retail Settlement on July 14, 1997, D.P.U. 96-25-A. On November 25, 1997, the FERC approved the amended Wholesale Settlement. See Docket No. ER97-678-000 for NEP, MECo's wholesale affiliate; see also, Docket No. ER97-680-000 for NEP's Rhode Island retail affiliate, Narragansett Electric Company ("Narragansett"). On November 25, 1997, the Massachusetts Legislature enacted an act relative to restructuring the electric utility industry ("Act"), and on December 23, 1997, the Department found that the MECo restructuring settlement previously approved by the Department was consistent with or substantially complied with the Act. D.P.U./D.T.E. 96-25-B (1997).

2 NEP's filing was made with MECo and Nantucket Electric Company (“NECo”). MECo and NECo are retail operating subsidiaries of NEES and are collectively referred to as MECo.

3 NERC owns a 20 percent partnership interest in the Ocean State Power units. On December 5, 1997, NEP amended its filing to reflect the proposed resale of the ownership interest in Ocean State Power, and transfer of contractual and standard offer obligations from USGenNE to subsidiaries of TransCanada Pipelines Limited. NEP requests that the Department make the findings necessary to allow NERC to become an exempt wholesale generator ("EWG").

will transfer the stock to USGenNE. Pursuant to G.L. c. 164, § 17A, NEP requests the Department's approval of the acquisition of NERC stock.

Pursuant to G.L. c. 164, § 14, NEP has filed a petition for authorization and approval to issue up to $100 million of new long-term debt, as from time-to-time may be necessary to support trigger payments of power purchase obligations. This debt may be in the form of bonds, notes, or debentures and may be issued under a mortgage indenture or other form of financing agreement. To the extent that the amount of financing necessary to fund the trigger payments exceeds $100 million, NEP would seek future authority from the Department to raise the additional funds through the issuance of long-term debt. NEP also requests that the Department authorize, as in the public interest, an exemption from the invitation of proposals to purchase requirements of G.L. c. 164, § 15 and the par value requirements of G.L. c. 164, § 15A.

II. PROCEDURAL HISTORY

On October 1, 1997, pursuant to the terms of the restructuring settlement approved by the Department in docket D.P.U. 96-25, NEP filed a petition with the Department requesting approval to sell substantially all of the Company's non-nuclear generating assets to USGenNE.[4] The Department docketed the petition as D.P.U. 97-94.

Pursuant to notice duly issued, the Department held public hearings in Lenox, Worcester, and North Andover on October 28, 29, and 30, 1997, respectively, to receive public comment regarding the petition. The Office of the Attorney General filed a notice of intervention, and the Department allowed the intervention of the Cambridge Electric Light Company, Canal Electric Company, and Commonwealth Electric Company (together "ComEnergy"); the Division of Energy Resources ("DOER"); Eastern Edison Company and Montaup Electric Company; Enron Capital and Trade Resources, Inc. ("Enron"); Pawtucket Power Associates; Wyman-Gordon Company; and USGenNE. In addition, the Department granted limited participant status to Boston Edison Company, Eastern Utilities Associates, Western Massachusetts Electric Company, and Ogden Haverhill Associates ("Ogden").

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[4] On October 1, 1997, pursuant to Section 203 of the Federal Power Act ("FPA"), NEP, Narragansett and USGenNE also filed an application for authorization of the proposed sale of certain FERC jurisdictional facilities as part of the divestiture transaction, and pursuant to Section 205 of the FPA, NEP and USGenNE filed several proposed amendments to existing rates in connection with implementation of the divestiture transaction. In addition, NEP, USGenNE, and AllEnergy Marketing Company, L.L.C., an affiliate of NEP, filed proposed market-based power sales rates. <u>See</u> Docket Nos. EC98-1-000 and ER98-6-000. On October 15, 1998, pursuant to Section 8 of the FPA, NEP and USGenNE filed applications for approval to transfer the licenses for NEP's hydroelectric facilities to USGenNE. On February 25, 1998, the FERC approved the proposed divestiture transaction, accepted for filing NEP and AllEnergy's market-based rates, conditionally accepted for filing USGenNE's proposed market-based rates, and conditionally accepted for filing NEP's and USGenNE's proposed agreements and amendments to existing rates. On February 27, 1998, the FERC approved the transfer of the hydroelectric licenses.

In support of its petition, the Company offered the testimony of Michael Jesanis, vice-president and treasurer of NEES; Thomas Widener, director of the investment banking group at Merrill Lynch & Co.; Paul Levy, an independent consultant to the Company; Jennifer Kenney, principal financial analyst for the Company; John G. Cochrane, assistant treasurer of NEP; and Peter Zschokke, manager of retail rates for the Company. Enron sponsored the testimony of Richard Levitan, president of Levitan and Associates. In rebuttal testimony, the Company sponsored testimony from Joe D. Pace, managing director of LECG, Inc.; and Michael Hachey, vice president and director of generation marketing for NEP.

The Department held evidentiary hearings to review the proposed transaction on January 13, 15, 16, and 29, 1998. The evidentiary record consists of the testimony of the Company and intervenor witnesses, 147 exhibits, and the responses to 23 record requests.[5] Initial briefs were submitted by the Company, DOER, Enron, Ogden, and USGenNE. Reply briefs were submitted by the Company, the Attorney General, and Enron.[6]

III. DESCRIPTION OF THE DIVESTITURE TRANSACTION

A. Introduction

The divestiture transaction consists of several related agreements (Exh. NEP-2, at 9):

1. The Asset Purchase Agreement governs the terms of the transaction as a whole among NEP, Narragansett, and USGenNE (id.).

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[5] The Department grants Enron's February 12, 1998 request to mark previously submitted documents as Exhibits NEES-1, NEES-2, NEES-3, ECT-4, ECT-5, and ECT-6.

[6] Ogden submitted comments regarding an issue in the Company's reply brief, and the Company submitted comments in response.

2. The Continuing Site/Interconnection Agreement governs the relationship between NEP and USGenNE after the closings (id.).

3. The IPP Contracts Transfer Agreement governs the transfer to USGenNE of the economic benefits and obligations of the NEP Power Purchase Agreements (id.).

4. The Wholesale Customer Support Agreements govern the transfer to USGenNE of the economic benefits and obligations of the NEP Power Supply Agreements (id.).

5. The Wholesale Standard Offer Service Agreements govern the provision of wholesale power to MECo for standard offer service (id.).

6. The Nuclear Wholesale Power Agreement governs the sale of the output of NEP's nuclear interests (id.).

1. Asset Purchase Agreement

The Asset Purchase Agreement governs the sale to USGenNE of substantially all of the non-nuclear generating business of NEP and Narragansett, including NEP's interests in purchased power agreements ("PPAs"), but excluding NEP's interest in the Wyman 4 generating station, which will be sold separately, and certain small diesel units in three locations (id.). The parties to the Asset Purchase Agreement are NEP, Narragansett,[7] and USGenNE (id.).[8]

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[7] Narragansett's participation is limited to the transfer of its ownership interest in the Manchester Street Generating Station. Hereafter, NEP and Narragansett are collectively referred to as NEP.

[8] PG&E Corporation has guaranteed the performance by USGenNE of all of USGenNE's obligations under the Asset Purchase Agreement and the IPP Contracts Transfer Agreement.

Under the Asset Purchase Agreement, USGenNE will pay $1.59 billion for substantially all of NEP's non-nuclear generating assets (id.).[9] In addition, USGenNE will pay NEP $85 million to cover the cost of early retirement, severance, and retraining programs for employees of the NEES companies affected by the sale and by the introduction of retail choice (id.). New England Power Service Company ("NEPSCo"), a service company subsidiary of NEES, will assign its interest in the collective bargaining agreements and any other appropriate agreements or assets to USGenNE (id. at 13).

In addition to the purchase price, NEP will be reimbursed for certain specified maintenance and capital expenditures made during the period from the signing of the Asset Purchase Agreement to the closing (id. at 10). NEP will also be reimbursed for the net book value, as of each closing date, of all fuel inventory and stores inventory relating to the purchased assets (id.). Finally, USGenNE will assume the liabilities and obligations relating to the standard offer backstop obligation of NEP (id.).

2. Continuing Site/Interconnection Agreement

The purpose of the Continuing Site/Interconnection Agreement is to set forth the continuing obligations, responsibilities and liabilities of NEP and USGenNE as they relate to the operation, construction and maintenance of equipment; access to each other's property; provision of services; environmental protection; and safety (id. at 15). It requires NEP to provide

9 The purchase price was structured so that $1.45 billion will be paid at the closing and $225 million would be held back by USGenNE, subject to a post-closing adjustment based on the timing of implementation of retail choice in Massachusetts and New England. On March 1, 1998, pursuant to the Electric Restructuring Act, retail choice was implemented in Massachusetts. Accordingly, the $225 million holdback will be included in the closing payment (Tr. 1, at 19).

interconnection service to USGenNE, describes the points of interconnection, the costs, and the obligations and responsibilities of USGenNE as an interconnection customer of NEP (id.).

3. IPP Contracts Transfer Agreement

Pursuant to the Asset Purchase Agreement, NEP has committed to try to assign the power purchase agreements ("PPAs") to USGenNE prior to the closing (id. at 16). With respect to those PPAs not assigned prior to the closing, NEP will make available to USGenNE, at the point at which a power seller makes delivery to NEP, all energy and any other benefits NEP receives under each PPA from such power seller (id.). NEP will then reimburse USGenNE for all costs reasonably incurred by USGenNE in transmitting such energy to the New England Power Pool ("NEPOOL") pool transmission facility system, and NEP will continue to make payments to power sellers under unassigned PPAs (id.). USGenNE will pay NEP, on a monthly basis, all amounts properly due from NEP to a power seller for the preceding month, less the amount of a monthly support payment to the power sellers in support of the PPAs (id.). The IPP Contracts Transfer Agreement also provides that USGenNE may enter into amendments to the PPAs on NEP's behalf, which could reduce the amounts USGenNE would pay to NEP (Exh. NEP-1, Book 5, at 98).

Upon certain events, e.g., assignment, termination, or reduction, the IPP Contracts Transfer Agreement provides that NEP will make a trigger payment to the power suppliers, or as otherwise designated by USGenNE (id.). In the case of assignment or termination, the value of the trigger payment will be based on the discounted present value of the support payment stream, multiplied by the percentage of the support payment stream allocated to the relevant PPA (id.). In the event that NEP defers the trigger payments, it would provide USGenNE with a security interest in the portion of the contract termination charge equal to the fixed contributions which were the subject of the payment (Exh. NEP-7, at 20).

4. Wholesale Customer Support Agreements

Under the Wholesale Customer Support Agreements, all electric energy will be delivered to NEP at the point at which the third party power purchaser takes delivery from NEP under the terms of the power sales agreement (Exh. NEP-2, at 17). USGenNE is responsible for making all arrangements necessary for the transmission of such energy to such delivery points, and NEP will pay to USGenNE all amounts it receives from such third party power purchaser for the preceding month under each power sales agreement (id.).

5. Wholesale Standard Offer Service Agreements

USGenNE has entered into Wholesale Standard Offer Service Agreements with MECo and Narragansett to provide wholesale power to enable the retail companies to continue to serve their customers, to the extent that those customers elect standard offer service, and that service is not procured by the retail company through a bid process (id. at 18).[10]

6. Nuclear Wholesale Power Agreement

[10] On February 23, 1998, MECo conducted an auction to procure a supply for standard offer service, and on February 24, 1998, MECo advised the Department that it received no conforming bids in the auction. As a result, NEP remains responsible for providing all of MECo's standard offer service requirements prior to divestiture, and USGenNE and TransCanada would assume the standard offer obligation after divestiture. On February 24, 1998, NEP and MECo filed an amendment with the FERC to modify their service agreement to make default service available to MECo during the period prior to divestiture.

Under the Nuclear Wholesale Power Agreement, NEP has offered USGenNE an option on 98 percent of the output of NEP's nuclear interests (id.). USGenNE may purchase that output at the lower of standard offer prices or NEPOOL spot prices (id.). The Nuclear Wholesale Power Agreement will terminate if NEP sells its nuclear interests or if USGenNE no longer has an obligation to provide standard offer service (id.).

B. The Divestiture Process

Initially, the Company, noting the value of proceeding as expeditiously as possible, identified, targeted, and qualified potential purchasers of its non-nuclear generating facilities (Exh. NEP-8, at 4-6). Following the identification and qualification of potential purchasers, the Company implemented a two-stage sale process (id. at 6). In the first round, NEP sought non-binding proposals that would be used to determine who among prospective purchasers was likely to place the highest value on the generating business (id.). The first round also was used to conduct market testing of potential sale parameters such as how to deal with the above-market power contracts and the willingness of prospective purchasers to assume collective bargaining agreements (id. at 7). The second round involved the submission of binding proposals from a relatively small group of finalists comprising those prospective purchasers deemed most likely to provide maximum value for the business (id.). Once second round bids were received, the Company conducted further negotiations with the top bidders (id.).

NEP opened a data room in Boston to provide prospective bidders the opportunity to review documents containing detailed technical data, operating history and information on the generating stations, and on the PPAs (id. at 11). As part of the data room process, prospective bidders also were allowed to submit written questions, and answers to those questions considered material to the preparation of an initial proposal were provided to all prospective bidders (id.).

Bidders from the first round were short-listed based on an assessment of which were most likely to provide maximum value in the second round (id. at 15). The Company considered the price, other proposal terms, and the ability and track record of the bidder to deliver on its bid and to close the sale (id.).

In the second round, bidders were provided access to detailed information to allow them to formulate their own assumptions with regard to environmental and relicensing issues and to price those assumptions into their proposals (id.). Bidders also were required to assume the collective bargaining agreements (id.). In addition, the PPAs were grouped with the fossil business unit, together with a fixed schedule of payments from NEP for assumption of these obligations (id.). Further, bidders were given the opportunity to commence their final due diligence efforts, including access to NEP's facilities and meetings with NEP and NEPSCo personnel (id.). Finally, bidders were also given the opportunity to discuss the PPAs with the power suppliers, their lenders, and fuel suppliers and transporters.

C. Impact of the Divestiture Transaction

1. Introduction

The divestiture transaction provides that NEP will recover the above-market costs of the investments and obligations that it has undertaken to provide service to MECo under its all-requirements service agreement through a contract termination charge ("CTC") pursuant to the Wholesale Settlement (Exh. NEP-10, at 2). These costs are categorized as (1) generation-related commitments, including natural gas conversion costs and above-market pipeline demand charges; (2) regulatory assets; (3) nuclear obligations including decommissioning costs; and (4) above-market payments to power suppliers for PPAs (id.). The formula for the calculation of the CTC segregates the specific costs associated with these four categories of commitments into fixed and variable components (id.). The fixed component is credited with the net proceeds realized upon the divestiture of NEP's generating business and related assets, and the variable component is adjusted for the assumption of any other obligations as a result of divestiture (id.).

The residual value credit reduces the fixed component by the amount of the proceeds paid to NEP by USGenNE, net of certain costs incurred by NEP as a result of divestiture (id.). The effect of crediting the residual value credit to the fixed component is that the resulting CTC collects only those unrecovered sunk generating plant and regulatory asset costs not recovered through the proceeds of divestiture (id.).

2. Modification to the Contract Termination Charge

a. Fixed Component

NEP proposes a modification of the formula that was reflected in the Wholesale Settlement to shorten the amortization of fixed component cost recovery, including residual value credit, to the period between the divestiture date and December 31, 2000, rather than through 2009 as initially reflected in the Wholesale Settlement (id. at 4). The change in the amortization period of the fixed component results from the fact that the provisions of the Wholesale Settlement for amortization of the fixed component and residual value credit effectively collected the entire post-divestiture unamortized fixed component in less than three years (id. at 8).

Within the first three years the annual amortization of the base fixed component exceeded the annual amortization of net proceeds included in the residual value credit by enough that, on a net basis, the entire amount of post-divestiture fixed component costs was completely collected (id.). Because the net fixed component costs would be completely recovered by year end 2000, the amortization collected in 2001 through 2004 would be collected only to be returned to customers through the amortization in the residual value credit in 2005 through 2009 (id.).

b. Variable Component

As part of the divestiture transaction, USGenNE is assuming the obligations of NEP under the various purchased power and fuel transportation contracts (id. at 17). NEP will pay an average of $160 million per year for approximately ten years to buy out of these contracts (id.). These payments come in the form of reductions in the payments that USGenNE must make to NEP under the contracts, and are fixed under the agreement with USGenNE (id.).

The above-market costs of the contractual obligations of NEP under the various purchased power and fuel transportation contracts are included in the variable component of the CTC. The payments required of NEP are lower than the above-market estimates included in the Wholesale Settlement (id. at 18). Because the buyout payments NEP will be required to make in conjunction with USGenNE's assumption of the obligations are lower than the related estimate of above-market costs included in the CTC, NEP has proposed to replace the previous estimates, rather than reconcile later (id. at 7).

3. Retail Settlement

The net proceeds from the divestiture transaction will reduce NEP's CTC to MECo per the Wholesale Settlement (Exh. NEP-12, at 3). Consequently, there will be a corresponding reduction in MECo's rates through the access cost adjustment mechanism of the Retail Settlement (id.). The reduction will be applied to all rate classes through a uniform cents per kilowatthour ("KWH") credit applied to the access charge of each rate class (id.).

If the divestiture transaction is approved, the CTC for 1998 would decrease from 2.8 cents per KWH to an estimated 1.5 cents per KWH (id. at 4). This decline in the CTC, on average, would provide estimated savings to customers in 1998 of approximately 18 percent off 1997 rates using a standard offer service price of 3.2 cents per KWH (id.).

The schedule of standard offer service prices is set at that appearing in the Wholesale Settlement (id. at 5). When the access charge is reduced by the residual value credit, the Retail Settlement provides that, to the extent that proceeds from the divestiture transaction reduce the access charge, MECo may implement a surcharge on the rate for standard offer service to eliminate any difference between the wholesale and retail standard offer prices and to recover any prior undercollections (id.). MECo proposes, as of the date of the divestiture transaction, to implement the standard offer surcharge (id. at 6). The amount of the surcharge in 1998 would equal the increment that the wholesale standard offer price exceeds 2.8 cents per KWH plus any additional amount necessary to recover any undercollection incurred between the start of retail choice and the divestiture date (id.).[11]

D. Positions of the Parties

1. Enron

Enron contends that in order to approve the proposed divestiture transaction, the Department must find that the process has maximized the value of the NEP assets (Enron Initial Brief at 2). Enron states that the criterion for judging a divestiture process is to examine the result, and that the Department should determine whether the auction maximized the value of the generation assets in comparison with the value obtained through the divestiture process by other New England utility companies (id. at 3). Enron contends that the results of comparable divestiture processes in New England demonstrate that the NEP auction has failed to maximize the value of the Company's assets (id. at 4).

Enron states that a fair assessment of the total value received in the divestiture transaction must include consideration of not only the net price received, but also what value, if any, ratepayers receive from the backstop obligation and the transfer of payment responsibility for the

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[11] MECo will make a supplemental filing with the Department prior to the date of the divestiture transaction to establish the amount of the surcharge based on the actual circumstances and the results of the wholesale auction for standard offer service.

PPAs to USGenNE (id. at 5). Enron contends that NEP has failed to maximize the value of its assets, and that this resulted from the standard offer backstop obligation and the requirement to assume the responsibility for the PPAs (id. at 10). Enron states that the Department cannot make a final assessment of the entire value NEP ratepayers will receive from the auction until it determines whether the benefits associated with the backstop obligation and the assumption of the responsibility for PPAs provide sufficient value to ratepayers to outweigh the substantially lower price that NEP actually received for its generation assets (id. at 11).

Enron contends that the Department should conclude that the standard offer backstop obligation was a significant reason why the value that it claims NEP received for the generating facilities is far below bids received for comparable assets in New England (id. at 21). Enron states that the backstop obligation would reduce a bid consistent with the difference between the bidders' projection of market price and the standard offer ceiling price (id.). Enron contends that it is reasonable to assume that bidders' expectations of prices are included in the range of forecasts contained in the record, and has calculated that the effect of the standard offer backstop obligation is from $480 to $688 million, assuming an "average" market forecast price projection (id. at 21-22). Enron contends that the Department does not need to focus on a precise quantification of the backstop obligation effect, but on the fact that the backstop obligation reduced the value NEP received for its generating assets (id. at 22).

Enron contends that the transfer of responsibility for the PPAs was not accomplished without substantial cost, and that the Company's numbers are not credible (id. at 13). Enron has identified two reasons for the claimed low value that the Company received for the transfer of responsibility for purchase power contracts. First, they incorporate an unreasonably low forecast of market prices. Second, they assume no contract mitigation (id. at 14). Enron contends that the Department must conclude that the Company would have additional mitigation opportunities if it retained the contracts and that a reasonable level of mitigation, and a more reasonable market price, should be assumed in calculating the expected above-market obligation of the power contracts (id. at 15).

2. The Attorney General

The Attorney General urges the Department to approve the divestiture transaction and grant the approvals requested in this case (Attorney General Initial Brief at 1). The Attorney General argues that the appropriate standard of review for determining whether the sale process is equitable and maximizes the value of the existing generation facilities is satisfied if an electric company divests its non-nuclear generation facilities in a competitive auction or sale through a process approved by the Department that ensured complete, uninhibited, non-discriminatory access to all data and information by any and all interested parties seeking to participate in the sale (id.). The Attorney General contends that the comparable sales approach, while probative, is not controlling (id. at 2). Moreover, the Attorney General contends that Enron has not established that the results of auctions of other Massachusetts electric companies are comparable (id.).

3. DOER

DOER contends that the formula for computation of the CTC contains no provision for the payment of interest related to cash working capital impacts (DOER Initial Brief at 1-2).

DOER states that interest income that might accrue to NEP as a result of the divestiture transaction should be applied to ratepayer savings (id.).

4. Ogden

Ogden states that the Department is required to find that NEP has taken all reasonable steps to mitigate to the maximum extent possible the total amount of transition costs, including the requirement to engage in good faith efforts to renegotiate, restructure, reaffirm, terminate, or dispose of existing contractual commitments for purchased power which exceed the competitive market price for such power (Ogden Initial Brief at 4-5). Ogden contends that NEP has not demonstrated that the IPP Contracts Transfer Agreement complies with the Act (id. at 5). Ogden also contends that the IPP Contracts Transfer Agreement effects an assignment contrary to the terms of its contract with NEP (id. at 6). Ogden states that it has conducted contract renegotiations and that separate renegotiation of its contract could result in more mitigation than has been achieved under the IPP Contracts Transfer Agreement (id. at 8-9). Ogden requests that the Department only approve the IPP Contracts Transfer Agreement with the condition that Ogden's contract be removed, and that a settlement agreement substantially in accordance with the proposals made between Ogden and NEP be effectuated (id. at 10).

5. USGenNE

USGenNE contends that the record in this proceeding demonstrates that the divestiture transaction is in the public interest and will benefit the ratepayers. USGenNE requests that the divestiture transaction be approved (USGenNE Initial Brief at 1).

6. NEP

NEP contends that the Department's review must be placed in the context of the overall sale process that NEP developed to maximize the value of the proceeds from the divestiture transaction to customers (Company Initial Brief at 16). The Company contends that this value must be measured in terms of reducing the total obligations of customers rather than maximizing the stated sale price of specific generating assets (id.). NEP states that the benefits to customers are not maximized by a high dollars per kilowatt ("KW") for plant capacity if customers are saddled with high-cost environmental liabilities, above-market contractual obligations, or price risk and volatility in transition service in the move to the competitive marketplace (id.). NEP states that the auction process was (1) fair to participants, providing pertinent, timely, and equivalent information to bidders; and (2) reasonably designed and implemented to yield a fair market valuation through the qualification of bidders, the grouping of assets, and the development and presentation of sale terms (id. at 18).

NEP contends that Enron has misconstrued the economic value of the divestiture transaction (Company Reply Brief at 4). The Company states that the prices ascribed to individual elements of the equation, whether cash for assets, the PPA copayments, or any other assumed obligation, are of limited relevance (id. at 5). The Company contends that Enron's comparability analysis based on one component of the transaction is not correct for several reasons (id.). First, the Company states that Enron has assumed that the copayments agreed to by NEP for the PPAs decreased the price paid by USGenNE for the power plants (id.). NEP contends that the opposite is the logical result. Second, the Company states that Enron has assumed that the dollars per KW of capacity realized in a transaction in which a buyer assumed no other obligations can be compared to the dollars per KW received in NEP's transaction in which the buyer will both pay cash and assume significant obligations that accrue to the benefit of customers (id.). The Company contends that they must be valued together to determine the total value of the transaction (id.).

NEP states that Enron, by using a comparable sales approach, has applied the wrong statutory standard for application to this case (id. at 6). The Company contends that the value of comparable plants as evidence applies only to a transfer of generating facilities to an affiliate (id.). The Company states that the requirement to divest generation facilities is satisfied if an electric company divests its non-nuclear generation facilities in a competitive auction or sale in a process approved by the Department (id.).

The Company states that it is impossible to quantify the effect the standard offer backstop obligation had on the bid price, and that the assignment of the backstop obligation is supported by a solid policy rationale (Company Initial Brief at 19). The Company contends that the trade-off between stranded cost reduction and protection to customers from the standard offer backstop is a reasonable one (id. at 20). The Company also states that the standard offer backstop provides customers with guaranteed savings through a firm and known price path and supply source during the transition to a competitive market (Company Reply Brief at 8). Its purpose was to provide customers with a measure of assurance in the event that unforeseen events occurred during the transition to fully competitive markets (id.).

The Company contends that the PPA transfer was an integral part of the entire transaction and that the auction process provided maximum mitigation potential and value to customers

(Company Initial Brief at 20). NEP contends that the auction assured that the mitigation potential for the PPAs was fully reflected in the price paid by USGenNE (id. at 23). NEP states that the contractual obligations will be subject to mitigation and will be offset by the actual market value of the power that will be purchased under the agreements (Company Reply Brief at 11). The Company contends that the risks associated with those mitigation efforts or market price forecasts lie with the buyer of NEP's generation facilities, and that these risks and rewards were fairly valued in the market and are fully reflected in the residual value credit that is being returned to customers (id.). NEP states that its customers would be relieved of a substantial portion of what would otherwise be stranded costs (id.).

With respect to DOER's concerns regarding the timing and cash working capital requirements, the Company agrees that differences in timing between closing and the payment date for taxes could create cash working capital effects (id. at 17). The Company states that both DOER and NEP have agreed to consider these effects at the time of closing (id.). The Company states that any issues that are not resolved at that time would be subject to the informal dispute resolution process of the Wholesale Settlement (id.).

E. Standard of Review

The Legislature has vested broad authority in the Department to regulate the ownership and operation of electric utilities in the Commonwealth. See, e.g., G.L. c. 164, § 76; Cambridge Electric Light Company, et al, D.P.U./D.T.E. 97-111, at 17 (1998). On November 25, 1997, the Massachusetts Legislature enacted "an act relative to restructuring the electric utility industry in the Commonwealth, regulating the provision of electricity and other services, and promoting enhanced consumer protection therein" ("Act"), St. 1997, c. 164. The Act requires that each electric company organized under the provisions of G.L. Chapter 164 file a plan for restructuring its operations to allow for the introduction of retail competition in generation supply in accordance with the provisions of Chapter 164. St. 1997, c. 164, § 193 (G.L. c. 164, § 1A(a)). The Act provides that an electric company that has filed a plan which substantially complies or is consistent with this chapter as determined by the Department shall not be required to file a new plan, and the Department shall allow such plans previously approved or pending before the Department to be implemented.

On December 23, 1997, the Department found that the MECo restructuring settlement previously approved by the Department was consistent with or substantially complied with the Act. Massachusetts Electric Company, D.P.U./D.T.E. 96-25-B at 16 (1997). Specifically, the Department found that the restructuring settlement included a commitment by NEP to divest its non-nuclear generation business to an unaffiliated third party after a competitive auction or sale, and that the proceeds from the sale be applied to reduce the amount of the transition costs. Id. at 12. Therefore, the Department found that the restructuring settlement was consistent with the divestiture mitigation requirements of the Act. Id. In addition, the Department found that the restructuring settlement's provision that required the Company to endeavor to sell, assign or otherwise dispose of its power contracts was consistent with the Act's requirement that an electric company seeking to recover transition costs take all reasonable steps to mitigate to the maximum extent possible any such transition cost including good faith efforts to renegotiate, restructure, reaffirm, terminate, or dispose of existing contractual commitments for purchased power. Id. at 15.

In this proceeding, the Department must determine whether the Company's plan to sell substantially all of its non-nuclear generating assets, as provided by the Asset Purchase Agreement, is consistent with the restructuring settlement that the Department has found substantially complies or is consistent with the Act. Because the Company has included the PPAs with the other assets being divested, in this proceeding, the Department must also determine whether the IPP Contracts Transfer Agreement is consistent with the restructuring settlement that the Department has found substantially complies or is consistent with the Act. A divestiture transaction will be determined to be consistent with a company's restructuring plan or settlement and the Act if the company demonstrates to the Department that the "sale process is equitable and maximizes the value of the existing generation facilities being sold." G.L. c. 164, § 1A(b)(1). A sale process will be deemed equitable and to maximize the value of the existing generating facilities being sold if the company establishes that it used a "competitive auction or sale" that ensured "complete, uninhibited, non-discriminatory access to all data and information by any and all interested parties seeking to participate in such auction or sale." G.L. c. 164, § 1A(b)(2).

F. Analysis and Findings

1. The Divestiture Transaction

a. Introduction

In its review of the divestiture transaction, the Department first reviews the auction process, and then reviews whether the proposed divestiture transaction maximizes the value to ratepayers of the assets being divested. As part of the later review, the Department will address Enron's contention that the Company did not maximize the value of the assets being divested.

b. Review of the Auction Process

The Company designed an auction process consisting of two rounds in order to determine how to maximize the value of assets (Exhs. NEP-7, at 8-9; NEP-8, at 3-7). For the first round, the Company identified and sought bids from the identified prospective bidders (Exh. NEP-8, at 8). In the first round, prospective bidders were given simplifying assumptions and considerable flexibility to construct bids for individual business groups or the business as a whole (id. at 11-14). The Company received 41 first-round, non-binding, bids for the (1) PPAs alone, (2) fossil-fired generating units ("fossil units") alone, (3) PPAs and the fossil units jointly, (4) hydro units alone, and (5) non-nuclear generating business as a whole (Exh. DPU-1-12). Bids for the PPAs specified various payment streams, including both fixed and variable payments over different time periods, that bidders would require in order to take over the PPA obligations (id.).

The Company reviewed information received in the first-round bids to determine how best to group the assets being divested (Exh. NEP-8, at 15-16). The Company determined that first-round bids were generally higher for fossil units and PPAs jointly rather than separately (id.). The

Company chose the highest first-round bidders to participate in the second round of bidding (id.; Exh. DTE-1-14). Second-round bidders were allowed to bid for the fossil units and PPAs jointly, the hydro assets alone, or the non-nuclear business as a whole (Exh. NEP-8, at 16). For the second round, the Company set a fixed price structure for the PPAs that was representative of the three highest first-round bids for the PPAs (Exhs. DTE-1-12; NEP-7, at 12). After reviewing second-round bids, the Company chose the highest bid, which was a single bid by USGenNE for the non-nuclear generating business as a whole (Exh. DTE-1-15). The Company then conducted negotiations to enter into the agreements that constitute the divestiture transaction. The Company has stated that by moving expeditiously, it was able to take advantage of a market characterized by more buyers than sellers (Exh. NEP-8, at 5). The Company contended that there was significant value in proceeding at a time when there was an imbalance of supply and demand for generating assets (id.). While not quantified, the Department finds that there was value in proceeding as expeditiously as possible with the sale of the Company's non-nuclear generating assets.

Bidders had full access to a data room with a large amount of relevant information, and were given the opportunity to submit questions regarding the facilities being divested. The Company provided responses to all questions received to all first-round bidders. In the second round, bidders had access to more detailed information in the data room and had access to the Company's facilities and personnel.

No party contended that process conducted by the Company was not equitable. The Department finds that the auction process designed by the Company was equitable, and that the

Company provided complete, uninhibited, and non-discriminatory access to all of the relevant data by all interested prospective buyers. In addition, the Department finds that the auction designed by the Company, including the two-stage review, was a reasonable approach to maximizing the value of the assets being divested.

c. Maximizing the Value of the Assets Sold

The Company contends that the divestiture transaction provides for the separation of generating facilities from transmission and distribution facilities, market valuation of generating facilities, mitigation of stranded costs, and the rate reduction required by the Act. The Company contends that the Department must consider the value to customers of the divestiture transaction as a whole, not the cash proceeds from the sale in determining whether the Company has maximized the value of its assets.

Enron has provided two analyses to support its position that the Company has not maximized the value of its assets. The first analysis, based on market projections, is used to support Enron's contentions that the backstop obligation depressed the sale price of the generating facilities, and the cost of including the PPAs with the fossil units outweighs the cost of retaining them. To arrive at its PPA estimate, Enron uses higher electricity price projections than the Company's projections, and projects savings in PPA costs through contract renegotiation. In its second analysis, based on comparable sales, Enron argues that the Company received less per KW of capacity sold than did two other New England utilities, Central Maine Power Company ("CMP") and Boston Edison Company ("BECo").

The Department will review Enron's contentions regarding the effect of the backstop obligation and the effect of including the PPA with the fossil units. With respect to Enron's comparable sales analysis, the information provided by Enron, while probative, is not dispositive of the value received by the Company in the divestiture transaction. See G.L. c. 164, § 1A(b)(2). Moreover, the comparable sales approach is included in the Act as a method by which to determine value of non-nuclear generation facilities and purchase power contracts that are transferred to an affiliated company. In this proceeding, the Company is divesting its non-nuclear generating facilities and PPAs by a sale in a competitive auction. Consistent with the standard of review, the Department must determine whether the sale process is equitable and maximizes the value of the existing generation facilities being sold, and provided complete, uninhibited, non-discriminatory access to all data and information by any and all interested parties seeking to participate in such auction or sale. Therefore, while the Department addresses Enron's comparable sales approach, it is not the standard by which the Department judges the divestiture transaction.

1. The Backstop Obligation

In D.P.U./D.T.E. 96-25-B at 14, the Department found that, as a provision of the Wholesale Settlement, the backstop obligation was consistent with the Act's requirement to provide a standard offer transition rate, while allowing the retail companies to provide universal service and the required rate reduction. The Department found that the Retail Settlement provided standard offer service through a transition period, and that the backstop obligation assured that the retail companies would have a source of supply available for standard offer service. Id. Therefore, the Department has previously addressed Enron's contention about the reasonableness of the backstop obligation as a provision of the restructuring settlement.[12] In this proceeding, the Department reviews Enron's factual contention that the backstop obligation precluded the Company from maximizing the value of existing generating facilities.

The backstop obligation could change the sale price of the assets, by the difference over time between the expected market price of electricity and the specified backstop prices, times the KWHs sold at the backstop prices.[13] All other things being equal, market prices below the backstop obligation prices would tend to increase the value of the assets being divested. Conversely, market prices above the backstop obligation prices would tend to decrease the price of the assets being divested.

The evidentiary record contains two electricity price forecasts provided by the Company (RR-DTE-1; Exh. DTE-8). The earlier price projection, developed in 1996 to support the above-market portion of the PPAs in the Department's review of the Wholesale Settlement, projects electricity prices below the backstop obligation prices. The later price projection provided by the Company, while substantially above the initial price projection, is also below the backstop obligation prices.

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12 Enron was a party to the Department's review of the restructuring settlement in docket D.P.U. 96-25. Enron did not appeal the Department's Orders approving the restructuring settlement. D.P.U. 96-25, D.P.U. 96-25-A. In addition, Enron did not appeal the Department's Order finding that the restructuring settlement is consistent with or substantially complies with the Act. D.P.U./D.T.E. 96-25-B.

13 Other influences on the sale price of assets include expected revenues and operating costs, the value of sites for new or expanded generation, and opportunities for pollution reduction.

To support its contention that the Company's price forecasts are unrealistically low, Enron has relied on two higher price forecasts (Exh. DTE-5: RR-NEP-3). Both of Enron's price projections are above the backstop obligation prices. Based on its price projections, Enron claims that the effect of the backstop obligation on the sale price is between $480 and $688 million. See RR DTE-8.

There is considerable uncertainty in projections of the price of electricity (Enron Initial Brief at 14, 21-22). While Enron has provided two estimates of the backstop obligation effect, Enron contends that precise quantification is not necessary because the record supports its contention that the backstop obligation prevented the Company from maximizing the value of the assets being divested. The Company contends that the backstop obligation, as a transition mechanism, provides value to customers, but that quantification of that value is not possible. For standard offer service customers, any reduction in the value received for the assets being divested as a result of the backstop obligation is offset by a reduction in standard offer service procurement costs. See Eastern Edison Company, D.P.U./D.T.E. 96-24, at 81-82 (1997). Therefore, the backstop obligation does not result in a failure to maximize mitigation of transition costs and the recovery of such costs from ratepayers.

The backstop obligation also provides additional value as both a transition and an insurance mechanism. As long as the backstop obligation is the source of standard offer service supply, customers benefit from a known price path in the event that market prices exceed current projections. The Department values, and notes that customers also value, the certainty of a known price path through the orderly transition to a competitive marketplace. See Electric

Industry Restructuring, D.P.U./D.T.E. 96-100, at 136-138 (December 31, 1996); D.P.U. 96-25, at 25-26; D.P.U./D.T.E. 96-25-B at 14. The backstop obligation provides this certainty.

Enron's price projections differ from those of the Company's. However, the record does not contain any evidence that would allow the Department to find one projection more accurate than another throughout the transition period. Given the uncertainty of electricity price projections and the unquantifiable nature of the value of the backstop obligation as a transition mechanism, the full value of the backstop obligation can not be precisely calculated. Moreover, because the impact of the backstop obligation is netted against the reduction in the cost of standard offer service and the Department has found additional value in the backstop as a transition mechanism, precise quantification is not necessary. With these uncertainties, the Department finds that the value to standard offer customers of a known price path during the transition period outweighs the potential cost of the backstop obligation. Accordingly, the backstop obligation did not prevent the Company from maximizing the value of the assets being divested. See D.P.U./D.T.E. 96-24.

2. The PPA Transfer Agreement

The costs associated with the PPAs, given the terms of the various contracts, are a function of the future price of electricity and the mitigation achievable by renegotiation. The Department reviews the impact of the future price of electricity on the decision to include the PPAs with the assets being divested, however, the combined effect of future electricity prices and mitigation achievable by renegotiation must be considered in the context of including the PPAs with the generating facilities being divested in determining whether the Company maximized the value of the assets being divested.

The Wholesale Settlement approved by the Department provided that the Company would recover, subject to reconciliation, the above-market portion of its PPAs. The IPP Contracts Transfer Agreement provides that the Company would make fixed payments averaging $161 million a year over ten years to USGenNE for assuming the PPA obligations (Exh. NEP-1, Book-5, at 114). The effect of this provision of the IPP Contracts Transfer Agreement is to fix ratepayer exposure for the above-market portion of the PPAs, and shift the risks and rewards of future electricity prices and PPA renegotiations to USGenNE. Therefore, the IPP Contracts Transfer Agreement is consistent with the restructuring settlement approved by the Department.

The interaction of the electricity price projections and the fixed payment stream could, with inclusion of the PPAs with the assets being divested, affect the price received for the assets being divested. Given the fixed payment stream, future electricity prices above the fixed payment stream would increase the price of the other assets being divested, while electricity prices below the fixed payment stream would decrease the price of the other assets being sold. There is, of course, uncertainty about the future price of electricity. Information received from bidders during the first-round of bidding allowed the Company better to define the level of price uncertainty. The fixed price stream resulted from this market-based information. Because the Company has included the PPA obligations with the assets being divested, the bidders also have included their individual perceptions of future electricity prices in the price offered for the assets being divested.

With respect to the requirement to mitigate costs in excess of the projected market value of the power associated with the PPAs, the Act provides that approval of previously filed or approved plans shall be deemed to satisfy the requirements contained in G.L. c. 164, Section 1G, including the reasonable mitigation of transition costs. G.L. c. 164, § 1A(a). In that the Department has approved the Company's restructuring plan, the Department finds that the Company has satisfied the Act's requirement to mitigate the above market costs of the PPAs. Even though the Department has approved the Company's previously-filed restructuring settlement, the Department addresses whether the IPP Contracts Transfer Agreement otherwise satisfies the Act's requirement to mitigate costs in excess of the projected market value of the power associated with the PPAs.

In order to determine whether the IPP Contracts Transfer Agreement satisfies the Act's requirement to mitigate contractual commitments for purchase power which exceed the competitive market price, the Department must consider the effect of the IPP Contracts Transfer Agreement. Any electric company seeking to recover transition costs shall mitigate any such costs. G.L. c. 164, § 1A(d)(1). Mitigation efforts which an electric company shall engage in include good faith efforts to renegotiate, restructure, reaffirm, terminate, or dispose of existing contractual commitments for purchased power which exceed the competitive market price for such power. Id. For electric companies with Department-approved divestiture plans, the Act provides that an assignment of contracts to a buyer with adequate financial resources would satisfy the mitigation requirement for purchase power which exceed the market price.[14] G.L. c. 164, § 1A(d)(2)(i).

In any assignment, the marketplace would have an opportunity to value the contract, and any above-market portion of the contract obligation would be identified.[15] The IPP Contracts Transfer Agreement has provided the marketplace with an opportunity to value the contracts and their mitigation potential. Moreover, both Enron and the Company have provided evidence of the mitigation potential available through contract renegotiation, and individual bidders also were able to value the potential for renegotiation (RR-DTE-7, RR-DTE-10). As with the marketplace perceptions of future electricity prices, because the Company has included the PPA obligations with the assets being divested, the bidders have included contract mitigation potential in the price offered for the assets being divested. PPAs with significant mitigation potential would increase the prices of the other assets being divested. Because the value of the PPAs is implicit in the overall bid price, the Department finds that the inclusion of the PPAs with the other assets being divested does not result in a failure to maximize the mitigation of transition costs. In addition, the IPP Contracts Transfer Agreement provides for a restructuring, with a commitment to accomplish a novation of the PPAs (Exh. NEP-1, book 5, at 103). Therefore, the IPP Contracts Transfer

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14 The Act uses the term "assignment" of such contracts, but the operative language describes a novation. The IPP Contracts Transfer Agreement provides that both NEP and USGenNE agree to use reasonable efforts so that NEP would be released of all further liabilities and obligations, and USGenNE would be directly in contract with the IPPs (Exh. NEP-1, book 5, at 103).

15 The Department does not reach a determination on whether the IPP Contracts Transfer Agreement is an assignment of the PPAs. The effect of the IPP Contracts Transfer Agreement is to provide the market valuation that an assignment would provide.

Agreement is consistent with the Act's requirement to mitigate contracts for purchase power which exceed the market price.

Ogden argues that, because NEP has not renegotiated the Ogden PPA, the Company has not maximized the value of its assets. Although Ogden's proposed contract amendments might offer substantial savings, USGenNE, like other bidders, factored the prospective savings from renegotiating the Ogden PPA into the total price it bid, and, as with the mitigation potential of the other PPAs, ratepayers received the value of the proposed savings. Further, the Act does not require the renegotiation of the Ogden PPA.[16] Therefore, the Department finds that the Company's failure to pursue Ogden's offer further at this time does not demonstrate that the Company has not maximized the value of the divested assets.

3. <u>Comparison to Other Divestitures</u>

Enron contends that the Company received only $400 million for its divested assets ($1.59 billion for 4 million KW of capacity from generating plants, less $1.2 billion, the net present value of payments to USGenNE for taking the PPAs). Based on its analysis, Enron states that the Company received about $100 per KW or 0.36 times book value. Enron contends that this is approximately 25 percent of the sale price that BECo received for its divested assets and less than 10 percent of CMP's sale price (Enron Brief at 8). The Company contends that not only is

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16 The Restructuring Act, G.L. c.164 § 1G(d)(2)(i), provides: "In order to mitigate any costs in excess of the projected market value of power associated with purchased power contracts ..., except with respect to facilities which burn trash to generate electricity, electric companies and the sellers under such contracts shall make good faith efforts to renegotiate those contracts...." The Ogden facility burns trash to generate electricity (Ogden Brief at 1). While the Restructuring Act does not obligate the Company to renegotiate Ogden's PPA, the Restructuring Act does not prohibit such renegotiation.

USGenNE paying $1.59 billion for the non-nuclear generating business, it is paying $85 million toward employee severance and retraining costs, and it is assuming fuel transportation contracts with an estimated above-market cost of $329 million (Company Brief at 1-2; Company Reply Brief, Att. 1, at 1). The Company contends that the value of the backstop obligation and the reduction in PPA stranded cost payments should be added to the amount received, for a total value of more than $3 billion. The Company contends that this exceeds the price per KW received by BECo and is comparable to the price received by CMP (Company Reply Brief at 3-4, Att. 1).

The $1.59 billion price for the non-nuclear generating business and the $85 million toward employee severance and retraining costs are known amounts which do not depend on projections. USGenNE's assumption of an estimated $329 million in fuel transportation contracts also provides substantial value to the Company's customers, a value that depends on fuel price projections. The Department also notes that neither CMP nor BECo included a backstop obligation, and while the value of the backstop obligation cannot be precisely determined, the Department has found the value of the backstop obligation outweighs the potential costs. The Company has received a firm value of $1.675 billion ($1.59 billion for the business plus $85 million for employee costs) for its assets and additional value for fuel transportation, the backstop obligation, and PPA obligations and mitigation. These considerations must be factored in for comparability purposes. The Department finds that Enron has understated the value of the Company's divestiture in its comparisons to other divestiture transactions, and has not shown that the Company received less per KW for its assets than did other companies in New England.

Moreover, each divestiture transaction is unique. Elements such as timing and participation in the divestiture transactions of New England electric companies play a large role in the prices bid. There have been few large generation asset sales in New England and there are large relevant differences among the assets being sold. Therefore, in determining the value received in a particular divestiture transaction, reliance on a comparison with other sales which might not be comparable is less probative than a competitive auction which exhibits complete, uninhibited, non-discriminatory access to all data by all interested prospective buyers.

d. Conclusion

The Department has rejected Enron's contention that the Company has failed to maximize the value of the assets sold because it included PPAs with the other assets being divested. Further, the Department has found that the backstop obligation did not prevent the Company from maximizing the value of the assets being divested. In addition, the Department has rejected Enron's contention that the Company received far less for its assets than did comparable companies. Therefore, the Department rejects Enron's claim that the Company did not maximize the value of the assets being sold. The Department also has rejected Ogden's claim that the Company did not maximize the value of the assets being divested.

Based on its review of the auction process and the bids received, the Department finds that the Company conducted a competitive auction, including complete, uninhibited and non-discriminatory access to the relevant data by all interested prospective buyers, that maximized the value of the assets divested. The Department also finds that the process was appropriate and the value of the divestiture transaction is reasonable and consistent with the public interest.

Accordingly, the Department finds that the divestiture transaction is consistent with the restructuring settlement and approves the proposed divestiture, subject to reconciliation for those matters specified in the restructuring settlement and the divestiture transaction.

2. Modifications to the Contract Termination Charge

Consistent with its restructuring plan, the Company has proposed to revise the variable cost component and the amortization of the fixed component of the transition charge in order to maintain a stable and declining pattern of the contract termination charge as offset by the residual value credit (D.P.U. 96-25, Exh. MECo-11, vol. 2, at 55, n.9). Under the Company's proposal, the transition charge would (1) be at least 1.3 cents per KWH lower than the pre-divestiture schedule of charges every year from 1998 through 2003; and (2) decline every year through 2013, but only once before 2008 by more than 6 percent from the previous year (Exh. NEP-10, exh. JLK-2, sch. 1, at 1; D.P.U. 96-25, Exh. MECo-10, vol. 2, at 62). In contrast, without the Company's proposed changes, the transition charge would (1) not fall below the pre-divestiture schedule of charges by as much as 1.3 cents per KWH until 2002; (2) increase significantly in four years; and (3) decline by more than 18 percent three times by 2005 (Exh. NEP-10, exh. JLK-1, sch. 1, at 1; D.P.U. 96-25, Exh. MECo-10, vol. 2, at 62).

The Company's proposed treatment of the fixed and variable components of the transition charge provides a stable and declining pattern of transition charges to customers, particularly when compared with the default schedule of charges derived directly from the Company's restructuring plan. Moreover, the Company's proposal provides substantial near-term rate relief compared to the default schedule of charges. The Department finds that the Company's proposal is consistent with the Department's goals of near term rate relief, rate stability, and an orderly, expeditious transition to competition. See D.P.U. 95-30, at 30. In addition, the Company's proposal is consistent with the Act's requirement to provide an estimate and detailed accounting of total transition costs eligible for recovery, and the proposed charges for recovery of such transition costs. G.L. c. 164, § 1G(d). Accordingly, the Department approves the Company's proposed schedule of transition charges, as shown in Exh. NEP-10, exh. JLK-2, subject to reconciliations at closing and at the reconciliation dates specified in the restructuring plan and the purchase and sale agreements.

IV. DESCRIPTION OF THE PROPOSED FINANCING

A. Issuance of Long-term Debt

Pursuant to the IPP Contracts Transfer Agreement, NEP is obligated to use reasonable efforts to obtain and maintain, from all regulatory authorities having jurisdiction, approvals for the issuance of up to $100 million in long-term securities for the purpose of funding trigger payments if such payments become necessary (Exh. NEP-11, at 2-3). According to the Company, trigger payments occur upon certain events such as assignment of a power purchase agreement to USGenNE, termination of a power purchase agreement, or changes to an agreement resulting in a reduction of the obligations under a power purchase agreement (id.). To meet this obligation, NEP is requesting authority for the issuance of up to $100 million of long-term debt, which may be in the form of bonds, notes, or debentures (“NEP Notes”). NEP contends that the net utility plant test supports its request for up to $100 million of NEP Notes (id.).

NEP requests authority to issue the NEP Notes through December 31, 2000 with a maximum interest rate of 11 percent (id. at 3, 5). NEP proposes to issue one or more series of NEP Notes with various terms of maturity, but not more than 30 years from the date they are issued (id. at 5).

B. Exemption from G.L. c. 164, § 15

NEP maintains that its readiness to respond quickly to market changes is important for effective utilization of both negotiated offerings and sales through agents (id. at 5). Therefore, NEP requests that the Department grant an exemption from the public bidding requirements of G.L. c. 164, § 15 so that it may respond more quickly to market changes which response, as stated above, is essential to the facilitation and effectiveness of negotiated offerings and sales through agents (id. at 5-6).

C. Exemption from G.L. c. 164, § 15A

NEP proposes that the NEP Notes be issued under a mortgage indenture or other form of financing agreement and sold at a price, exclusive of accrued interest and expenses, of not less than 95 percent nor more than 100 percent of their principal amount (id. at 4). Therefore, the Company is also seeking an exemption from the par value requirements for long-term debt in G.L. c. 164, § 15A. According to NEP, this provision provides a degree of flexibility in the pricing of the bond issue, and facilitates the sale of the notes (Company Brief at 10-11).

D. Transfer of the NERC Stock

NERC, a wholly owned subsidiary of NEES, owns a 20 percent partnership interest in the Ocean State Power units (Exh. NEP-7, at 10). As part of the divestiture transaction, NEES will contribute its stock in NERC to NEP at book value, and NEP will transfer the stock to USGenNE (id.). Pursuant to G.L. c. 164, § 17A, NEP requests the Department's approval of the acquisition of NERC stock (Exh. NEP-2, at 7). NEP also requests that the Department make the findings necessary to allow NERC to become an exempt wholesale generator under the Public Utility Holding Company Act (Exh. NEP-6, at 2).

E. Capital Structure of the Company

As of June 30, 1997, the Company’s utility plant in service was $3,033,642,651, with accumulated depreciation of $1,157,487,877 and property under capital leases of $67,012,492, resulting in a net utility plant of $1,809,142,282. As of June 30, 1997, the Company’s total capitalization was $1,245,874,419 consisting of long-term debt of $700,613,019, common stock of $128,997,920, premium on common stock of $86,779,300, other paid-in capital of $289,818,180, and preferred stock of $39,666,000. Therefore, the excess utility plant amounted to $563,267,863 as of June 30, 1997. The Company also provided a comparison of net utility plant to total capitalization reflecting the proposed divestiture (Exh. DTE-17). This demonstration reduces net utility plant by $1,007,662,456 to $801,479,826 and reduces total capitalization by $1,000,000,000 to $245,874,419 (id.). The $1,000,000,000 reduction to total capitalization is the Company’s representation of the proceeds of the divestiture remaining after taxes, transaction costs, and various reimbursements (id.). However, if NEP uses some of the proceeds to make trigger payments under the IPP Contracts Transfer Agreement, the total post-divestiture capitalization would increase, thereby reducing the stated excess of net utility plant over total capitalization (Tr. 1, at 71). The Company states that although a trigger payment does not create plant, it does represent a regulatory asset in the form of an obligation from customers to repay NEP (id. at 72). Therefore, NEP concludes that investors should continue to be willing to lend money to NEP (id. at 135).

F. Position of the Company[17]

The Company maintains that the purpose of the financing is to make the trigger payments consistent with the IPP Contracts Transfer Agreement, and that the assignment of these contracts benefits the customers by removing from the customers the risk that USGenNE might default in the future and call upon the customers to make those payment obligations (Tr. 1, at 124). NEP claims that the financing is reasonably necessary to fulfill a commitment in the agreements with USGenNE (Company Brief at 9). In addition, according to the Company, the $100 million requested authorization represents a small portion of the potential trigger payment obligations that could be as much as $1.2 billion (id.).

With respect to the Company's request for an exemption from the public bidding requirements of G.L. c. 164, § 15, NEP asserts that an exemption would allow a quick turnaround of the financing, if necessary, to capture lower interest rates or favorable market conditions (id. at 10).

With respect to the Company's request for an exemption from the par value requirements of long-term debt in G.L. c. 164, § 15A, NEP contends that such an exemption would provide a degree of flexibility in the pricing of the bond issue, and facilitate the sale of NEP Notes (id. at 10-11).

[17] No party commented on the Company's financing proposal.

With respect to the net plant requirements found in G.L. c. 164, § 16, NEP claims that it easily meets the Department's net plant test prior to the sale of its generating facilities and assuming no trigger payments are made (id. at 11). While the Company concedes that it would not be able to reduce its capitalization to the extent proposed if trigger payments are made over and above the $100 million reflected in the financing, NEP argues that the potential for a future impairment should not cause the Department to prescribe conditions or requirements on this requested financing as such action would be premature (id.). First, NEP contends that the net plant test requires that there be no impairment caused by the requested increase in financing, and that no impairment exists as a result of the requested financing, either before or after divestiture (id.). Second, the Company maintains that further Department financing approvals will be required to finance trigger payments at which point any impairment could be fully evaluated (id.). Third, NEP posits that the impairment analysis no longer properly represents the financial condition of the Company (id.). The Company points out that after restructuring and divestiture, payment for the security holders is made through the contractual commitments by the Company's wholesale customers who pay Contract Termination Charges, which are not considered assets for the purposes of G.L. c. 164, § 16 (id. at 11-12). NEP claims that when the contractual entitlements under the settlement are reflected in the analysis, the interest of security holders will be protected (id. at 12).

G. Standard of Review

In order for the Department to approve the issuance of stock, bonds, coupon notes, or other types of long-term indebtedness[18] by an electric or gas company, the Department must determine that the proposed issuance meets two tests. First, the Department must assess whether the proposed issuance is reasonably necessary to accomplish some legitimate purpose in meeting a company's service obligations, pursuant to G.L. c. 164, § 14. Fitchburg Gas & Electric Light Company v. Department of Public Utilities, 395 Mass. 836, 842 (1985) ("Fitchburg II"), citing Fitchburg Gas & Electric Light Company v. Department of Public Utilities, 394 Mass. 671, 678 (1985) ("Fitchburg I"). Second, the Department must determine whether the Company has met the net plant test.[19] Colonial Gas Company, D.P.U. 84-96 (1984).

The Supreme Judicial Court has found that, for the purposes of G.L. c. 164, § 14, "reasonably necessary" means "reasonably necessary for the accomplishment of some purpose having to do with the obligations of the company to the public and its ability to carry out those obligations with the greatest possible efficiency." Fitchburg II at 836, citing Lowell Gas Light Company v. Department of Public Utilities, 319 Mass. 46, 52 (1946). In cases where no issue exists about the reasonableness of management decisions regarding the requested financing, the Department limits its Section 14 review to the facial reasonableness of the purpose to which the proceeds of the proposed issuance will be put. Canal Electric Company, et al., D.P.U. 84-152, at 20 (1984); see, e.g., Colonial Gas Company, D.P.U. 90-50, at 6 (1990). The Fitchburg I and II and Lowell Gas cases also established that the burden of proving that an issuance is reasonably

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18 Long-term refers to periods of more than one year after the date of issuance. G.L. c. 164, § 14.

19 The net plant test is derived from G.L. c. 164, § 16.

necessary rests with the company proposing the issuance, and that the Department's authority to review a proposed issuance "is not limited to a "perfunctory review". Fitchburg I at 678; Fitchburg II at 842, citing Lowell Gas at 52.

Regarding the net plant test, a company is required to present evidence that its net utility plant (original cost of capitalizable plant, less accumulated depreciation) equals or exceeds its total capitalization (the sum of its long-term debt and its preferred and common stock outstanding) and will continue to do so following the proposed issuance. Colonial Gas Company, D.P.U. 84-96, at 5 (1984).

Pursuant to G.L. c. 164, § 15, an electric or gas company offering long-term bonds or notes in excess of $1 million in face amount payable at periods of more than five years after the date thereof must invite purchase proposals through newspaper advertisements. The Department may grant an exemption from this advertising requirement if the Department finds that an exemption is in the public interest. G.L. c. 164, § 15. The Department has found it in the public interest to grant an exemption from the advertising requirement where there has been a measure of competition in private placement. See, e.g., Western Massachusetts Electric Company, D.P.U. 88-32, at 5 (1988); Eastern Edison Company, D.P.U. 88-127, at 11-12 (1988); Berkshire Gas Company, D.P.U. 89-12, at 11 (1989). The Department also has found that it is in the public interest to grant a company an exemption from the advertising requirement when a measure of flexibility is necessary in order for a company to enter the bond market in a timely manner. See, e.g., Western Massachusetts Electric Company, D.P.U. 88-32, at 5 (1988). However, G.L. c.

164, § 15 requires advertising as the general rule, and waiver cannot be automatic but must be justified whenever requested.

Pursuant to G.L. c. 164, § 15A, a company is required to sell long-term bonds, debentures, notes, or other evidence of indebtedness at no less than the par value or face amount unless sale at less than par value is found by the Department to be in the public interest. See, e.g., Boston Edison Company, D.P.U. 91-47, at 13 (1991). The Department has found that it is in the public interest to grant an exemption from the par value requirement where market conditions make it difficult at times for a company to price a particular issue at par value and simultaneously offer an acceptable coupon rate to prospective buyers. Bay State Gas Company, D.P.U. 91-25, at 9 (1991). The Department also has found that it is in the public interest to authorize the issuance of debt securities below par value where this technique offers a company enhanced flexibility in entering the market quickly to take advantage of prevailing interest rates, particularly if this benefits the company's ratepayers in the form of lower interest rates and a lower cost of capital. Id.; see also Boston Gas Company, D.P.U. 92-127, at 8 (1992); Boston Edison Company, D.P.U. 91-47, at 12-13 (1991). If the Department authorizes a company to issue debt securities at less than par value, the Department may establish the method by which the company is required to amortize any discount.[20] G.L. c. 164, § 15A; see, e.g., Boston Gas Company, D.P.U. 92-127, at 8 (1992); Boston Edison Company, D.P.U. 91-47, at 15 (1991).

Where issues concerning the prudence of the Company's capital financing have not been raised or adjudicated in a proceeding, the Department's decision in such a case does not represent

[20] The discount is the difference between the par value of a bond, note, or other debt security and the actual issue price when the actual issue price is less than par value.

a determination that any specific project is economically beneficial to a company or to its customers. In such circumstances, the Department's determination in its Order may not in any way be construed as ruling on the appropriate ratemaking treatment to be accorded any costs associated with the proposed financing. See, e.g., Boston Gas Company, D.P.U. 95-66, at 7 (1995).

Pursuant to G.L. c. 164, § 17A, a gas or electric company must obtain written Department approval in order to "loan its funds to, guarantee or endorse the indebtedness of, or invest its funds in the stock, bonds, certificates of participation or other securities of, any corporation, association or trust . . . ." The Department has indicated that such proposals must be "consistent with the public interest," that is, a Section 17A proposal will be approved if the public interest is at least as well served by approval of the proposal as by its denial. Bay State Gas Company, D.P.U. 91-165, at 7 (1992); see Boston Edison Company, D.P.U. 850 (1983).

The Department has stated that it will interpret the facts of each Section 17A case on its own merits to make a determination that the proposal is consistent with the public interest. D.P.U. 91-165, at 7. The Department will base its determination on the totality of what can be achieved rather than a determination of any single gain that could be derived from the proposed transactions. Id.; see D.P.U. 850, at 7. The Department also found that the consistency standard best accommodates the Department's interest in protecting the utility's ratepayers from the adverse effects of unwarranted Section 17A transactions and a utility's interest in having flexibility in a changing marketplace to meet long term objectives of its ratepayers and shareholders. D.P.U. 91-165, at 7; Boston Edison Company, D.P.U. 97-17, at 6 (1997).

Thus, the Department's analysis must consider the overall anticipated effect on ratepayers of the potential harms and benefits of the proposal. D.P.U. 91-165, at 8. The effect on ratepayers may include consideration of a number of factors, including, but not limited to: the nature and complexity of the proposal; the relationship of the parties involved in the underlying transaction; the use of funds associated with the proposal; the risks and uncertainties associated with the proposal; the extent of regulatory oversight on the parties involved in the underlying transaction; and the existence of safeguards to ensure the financial stability of the utility. Id.

H. Analysis and Findings

The IPP Contracts Transfer Agreement requires that NEP issue up to $100,000,000 in long-term securities in order to support trigger payments to USGenNE. The Department has recognized that the financing requirements needed to implement the divestiture transaction would depend on the proceeds of the sales and the structure of the transaction. D.P.U. 96-25, at 28. The Department has found the IPP Contracts Transfer Agreement consistent with the restructuring settlement and the Act. Therefore, the Department finds that the proposed issuance of $100,000,000 of NEP Notes to be issued beginning on the divestiture date through December 31, 2000, and bearing an interest rate not to exceed 11 percent is reasonably necessary to accomplish a legitimate purpose in meeting the Company's obligations in accordance with G.L. c. 164, § 14.

The record demonstrates that NEP's post-divestiture assets would be greater than its post-divestiture capitalization. Therefore, the Department finds that the Company's proposed issuance of NEP notes meets the Department's net plant test. While there is a potential for future capital impairment if trigger payments exceed a certain level, further Department financing approvals will be required at which time the Department could determine whether conditions are necessary. Therefore, the Department finds that it would be premature to impose conditions on the proposed financing at this time.

Regarding the Company's request for an exemption from the requirements of G.L. c. 164, § 15, the Department finds that it is appropriate to allow the Company the flexibility offered by the private placement process in order to assist the Company's timely entry into the financial markets. Therefore, the Department finds it is in the public interest to exempt the Company from the advertising and competitive bidding requirements of G.L. c. 164, § 15.

Regarding the Company's request for an exemption from the par value requirements of G.L. c. 164, § 15A, the Department finds that the ability to issue debt securities below par value offers the Company increased flexibility in placing its issuances with the prospective underwriters. The Department finds also that this increased flexibility translates into an ability to issue debt securities in a timely manner to take advantage of favorable market conditions. The Department finds, therefore that the Company's request for an exemption from G.L. c. 164, § 15A is in the public interest and accordingly approves it.

While the issue of the amortization of the amount of any discount from par value was not addressed by the parties, the Department finds it appropriate to amortize any such discount over the life of the bond. See, Cambridge Electric Light Company, D.P.U. 96-91, at 8 (1996); Boston Edison Company, D.P.U. 94-60, at 14 (1994).

Regarding the Company's request under G.L. c. 164, § 17A for approval of the acquisition of NERC stock from NEES, the Department finds that such an acquisition is necessary to complete the divestiture transaction contemplated by the restructuring settlement and the Act. The Department has found the divestiture transaction consistent with the restructuring settlement and the Act. Therefore, the Department also finds the acquisition of the NERC stock to be reasonable and consistent with the public interest.

In D.P.U. 96-25, at 13, n.2, the Department, in approving the restructuring settlement, noted that it included a finding by the Department that the designation of EWG status of NEP's generating facilities would benefit consumers, is consistent with existing state laws, would not provide any unfair competitive advantage, and is in the public interest. In this proceeding, the Department has found that the acquisition of NERC stock is consistent with the restructuring settlement, reasonable and in the public interest. Therefore, the Department finds that the acquisition of NERC's entitlement in Ocean State Power would benefit consumers, is consistent with existing state laws, would not provide any unfair competitive advantage, and is in the public interest.

V. ORDER

Accordingly, after due notice, hearing and consideration, the Department

VOTES: That the divestiture transaction submitted by New England Power Company is approved, and the issuance by New England Power Company of bonds, notes, or debentures in the aggregate principal amount of $100,000,000 at an interest rate not to exceed 11 percent, is reasonably necessary for the purpose for which such issues have been authorized; and it is

ORDERED: That Massachusetts Electric Company and Nantucket Electric Company shall file notices with the Department pursuant to the Transition Cost Adjustment Provisions, M.D.T.E. 978-C and M.D.T.E. 422-C to reflect the proceeds of the divestiture transaction; and it is

FURTHER ORDERED: That Massachusetts Electric Company and Nantucket Electric Company shall file notices with the Department pursuant to the Standard Service Cost Adjustment Provisions, M.D.T.E. 981-A and M.D.T.E. 423 to reflect the proceeds of the divestiture transaction; and it is

FURTHER ORDERED: That the Department hereby approves and authorizes the issuance by New England Power Company of bonds, notes, or debentures with a maturity date of no later than December 31, 2000 in the aggregate principal amount of $100,000,000, at an interest rate not to exceed 11 percent; and it is

FURTHER ORDERED: That the bonds, notes, or debentures approved in this Order shall be used for the purposes as set forth herein; and it is.

FURTHER ORDERED: That the Secretary of the Department shall within three days of the issuance of this Order cause a certified copy of it to be filed with the Secretary of the Commonwealth.

By Order of the Department,

Janet Gail Besser, Chair

James Connelly, Commissioner

W. Robert Keating, Commissioner

Paul B. Vasington, Commissioner